

Determinations regarding nexus are very fact specific and cannot be addressed the context of a General Information Letter. See generally the enclosed copy of 86 Ill. Adm. Code 130.605. (This is a GIL).

November 18, 1999

Dear Ms. Xxxxx:

This letter is in response to your letter dated August 18, 1999. We apologize for the delay in responding to your inquiry. The nature of your letter and the information you have provided require that we respond with a General Information Letter, which is designed to provide general information, is not a statement of Department policy and is not binding on the Department. See 2 Ill. Adm. Code 1200.120(b) and (c), enclosed.

In your letter, you have stated and made inquiry as follows:

The purpose of this letter is to request a determination as to whether this firm's client, or a specific third party as discussed below, would be subject to Retailer's Occupation Tax, Service Occupation Tax, Service Use Tax or Use Tax.

The basic fact situation is as follows:

Our client (the 'Processor'), proposes to operate a processing facility located in Illinois, where it will be processing returns for publishers who are located outside Illinois (the 'Out-of-State Publisher'). The Out-of-State Publisher ships books to retail customers throughout the country via the U.S. Postal Service or private common carriers. Some of these books are rejected by the customers and returned to the Out-of-State Publisher via the U.S. Postal Service. The returns will be collected at a Postal distribution facility and sent to the Processor's Illinois facility. The Processor plans either (1) to strip the invoice and packaging from the book, record the return information, store the book until a truckload quantity is obtained, and return the book via private common carrier to the Out-of-State Publisher, or (2) process the information as set forth in (1) and repackage and ship the book directly to new customers of the Out-of-State Publisher, at the direction of the Out-of-State Publisher. In addition, the Processor may, at some future date, receive books directly from the Out-of-State Publisher and ship them directly to customers of the Out-of-State Publisher at the direction of the Out-of-State Publisher. The books would be warehoused at the Processor's Illinois facility for a maximum of thirty (30) days, and the Processor would not be responsible for accepting orders from the purchaser(s), obtaining payment or making refunds of the purchase price for the books.

For purposes of this analysis, please assume that the Processor is not a 'High Impact Service Facility' as defined in 35 ILCS § 120/1i.

We are requesting resolution to these questions:

1. Would the Processor have liability for Retailers' Occupation Tax under this scenario where consumers are within or outside of Illinois?
2. As a result of the location of the Processor's facility in Illinois, would the Out-of-State Publisher have liability for Retailers' Occupation Tax for consumers within or outside of Illinois?
3. Would the Processor have liability for Service Occupation Tax for customers located within Illinois or outside of Illinois?
4. Would the Out of State Publisher have liability for Service Occupation Tax because the processing facility is located in Illinois and is used for processing returns and/or sales to or from customers located within Illinois and outside of Illinois?
5. Would the Processor have liability for Service Use Tax for processing returns from and/or processing new sales to customers located within Illinois or outside of Illinois?
6. Would the Out of State Publisher have liability for Service Use Tax because the processing facility used for processing returns from and/or sales to customers located within Illinois and outside of Illinois is located in Illinois?
5. Would the Processor have liability for Use Tax for processing returns from and/or sales to customers located within Illinois or outside of Illinois?
6. Would the Out-of-State Publisher have liability for Use Tax because the processing facility used for processing returns from and/or sales to customers located within Illinois and outside of Illinois is located in Illinois?

Our Preliminary Analysis

We believe the outcome of the questions listed above to be as follows:

Question 1: The Processor would not have liability under the Retailers' Occupation Tax Act (35 ILCS §120/1 et. seq.) for customers resident within or outside of Illinois because the Processor is not a person 'engaged in the business of selling at retail tangible personal property.' 35 ICLS

§120/2 imposes the tax on 'persons engaged in the business of selling at retail tangible personal property.'

Question 2: The Out-of-State Publisher would not have liability for Retail Occupation Tax for consumers within or outside the State of Illinois as a result of the processing by the Processor. 86 ILAC 130.610(d)(1)(B) applies to the fact situation. It states that no Retailers' Occupation Tax liability will be incurred 'where the seller, from a point outside Illinois, makes an offer directly to the purchaser who transmits his acceptance directly to the seller outside Illinois.' No orders will be accepted directly from the customers by the Processor, nor will the Processor be authorized to accept such orders.

Question 3: The Processor would not have liability under the Service Occupation Tax Act (35 ILCS §115/1 et. seq.) because there is no 'tangible personal property transferred as an incident of a sale of service.' 35 ILCS §115/3 imposes the Service Occupation Tax upon all 'on all tangible personal property transferred as an incident of the sale of a service.'

Question 4. The Out of State Publisher would not have liability under the Service Occupation Tax Act (35 ILCS §115/1 et. seq.) because it is not a person 'engaged in the business of making sales of service.' 35 ILCS §115/3 imposes the Service Occupation Tax upon all 'persons engaged in the business of making sales of service.'

Question 5. The Processor would not be liable under the Service Use Tax Act (35 ILCS §110/1 et. seq.) because there is no 'tangible personal property acquired as an incident to the purchase of a service from a serviceman' as required by 35 ILCS §110/3.

Question 6. The Out of State Publisher would not be liable under the Service Use Tax Act (35 ILCS §110/1 et. seq.) because there is no 'tangible personal property acquired as an incident to the purchase of a service from a serviceman' as required by 35 ILCS §110/3.

Question 7. The Processor would not be liable under the Use Tax Act (35 ILCS §105/1 et. seq.) because there is no 'property purchased from at retail from a retailer' which would be subject to the tax imposed by 35 ILCS §105/3.

Question 8. The Out-of-State Publisher would not be liable under the Use Tax Act (35 ILCS §105/1 et. seq.) because there is no 'property purchased from at retail from a retailer' which would be subject to the tax imposed by 35 ILCS §105/3.

DEPARTMENT'S RESPONSE

Question 1: The Illinois Retailers' Occupation Tax Act imposes a tax upon persons engaged in this State in the business of selling tangible personal property to purchasers for use or consumption. See the enclosed copy of 86 Ill. Adm. Code 130.101. In Illinois, Use Tax is imposed on the privilege of using, in this State, any kind of tangible personal property that is purchased anywhere at retail from a retailer. See the enclosed copy of 86 Ill. Adm. Code 150.101. If the purchases occur in Illinois, the purchasers must pay the Use Tax to the retailer at the time of purchase.

Persons who process and deliver merchandise for others are not generally considered to be engaged in the business of selling tangible personal property. Therefore, they would not normally incur Retailers' Occupation Tax liability on the charges for such processing and delivery. However, they would generally be considered to be making sales of service. See the answer to question number 3 below regarding any potential Service Occupation Tax liability.

Question 2: Taxpayers may use the following guidelines concerning the different types of retailers in order to determine whether a business should remit and collect Illinois Retailers' Occupation Tax and Use Tax.

An "Illinois Retailer" is one who either accepts purchase orders in the State of Illinois or maintains an inventory in Illinois and fills Illinois orders from that inventory. The Illinois Retailer is then liable for Retailers' Occupation Tax on gross receipts from sales and must collect the corresponding Use Tax incurred by the purchasers.

Another type of retailer is the retailer maintaining a place of business in Illinois. The definition of a "retailer maintaining a place of business in Illinois" is described in 86 Ill. Adm. Code 150.201 subsection (i) (see enclosed). This type of retailer is required to register with the State as an Illinois Use Tax collector (see 86 Ill. Adm. Code 150.801 enclosed). The retailer must collect and remit Use Tax to the State on behalf of the retailer's Illinois customers even though the retailer does not incur any Retailers' Occupation Tax liability.

The final type of retailer is the out-of-State retailer that does not have sufficient nexus with Illinois to be required to submit to Illinois tax laws. A retailer in this situation does not incur Retailers' Occupation Tax on sales into Illinois and is not required to collect Use Tax on behalf of its Illinois customers. However, the retailer's Illinois customers will still incur Use Tax

on the purchase of the out-of-State goods and have a duty to self-assess their Use Tax liability and remit the amount directly to the State.

The United States Supreme Court in *Quill Corp. v. North Dakota*, 112 S.Ct. 1904 (1992), set forth the current guidelines for determining what nexus requirements must be met before a person is properly subject to a state's tax laws. The Supreme Court has set out a 2-prong test for nexus. The first prong is whether the Due Process Clause is satisfied. Due process will be satisfied if the person or entity purposely avails itself or himself of the benefits of an economic market in a forum state. *Quill* at 1910.

The second prong of the Supreme Court's nexus test requires that, if due process requirements have been satisfied, the person or entity must have physical presence in the forum state to satisfy the Commerce Clause. A physical presence is not limited to an office or other physical building. Under Illinois law, it also includes the presence of any agent or representative of the seller. The representative need not be a sales representative and it is immaterial for tax purposes that the representative's presence is temporary.

An out-of-State publisher that uses a company located in Illinois to deliver its merchandise or process its returned merchandise would generally not, in and of itself, give that out-of-State publisher nexus with Illinois for Retailers' Occupation Tax purposes. However, determinations regarding nexus are very fact specific and cannot be addressed in the context of a General Information Letter. See generally the enclosed copy of 86 Ill. Adm. Code 130.605.

Question 3: Retailers' Occupation Tax and Use Tax do not apply to receipts from sales of services. However, tangible personal property transferred incident to sales of service are subject to Service Occupation Tax liability. For your general information we are enclosing a copy of 86 Ill. Adm. Code 140.101 regarding sales of service and Service Occupation Tax.

Under the Service Occupation Tax Act, the purchase of tangible personal property that is transferred to service customers may result in either Service Occupation Tax liability or Use Tax liability for the servicemen, depending upon which tax base the servicemen choose to calculate their liability. Servicemen may calculate their tax base in one of four ways: (1) separately stated selling price of the tangible personal property being transferred; (2) 50% of the entire bill; (3) Service Occupation Tax on the cost price of the tangible personal property being transferred if they are registered de minimis servicemen; or, (4) Use Tax on the cost price of the tangible personal property being transferred if the servicemen are de minimis and are not otherwise required to be registered under Section 2a of the Retailers' Occupation Tax Act.

Using the first method, servicemen may separately state the selling price of each item transferred as a result of sales of service. The tax is based on the separately stated selling price of the tangible personal property transferred. If servicemen do not wish to separately state the selling price of the tangible personal property transferred, those servicemen must use 50% of the entire bill to their service customers as the tax base. Both of the above methods provide

that in no event may the tax base be less than the cost price of the tangible personal property transferred. Under these methods, servicemen may provide their suppliers with Certificates of Resale when purchasing the tangible personal property to be transferred as a part of the sales of service.

The third way servicemen may account for their tax liability only applies to de minimis servicemen who have either chosen to be registered or are required to be registered because they incur Retailers' Occupation Tax liability with respect to a portion of their business. Servicemen may qualify as de minimis if they determine that their annual aggregate cost price of tangible personal property transferred incident to sales of service is less than 35% of their annual gross receipts from service transactions (75% in the case of pharmacists and persons engaged in graphic arts production). See part (f) of the enclosed copy of 86 Ill. Adm. Code 140.101(f). This class of registered de minimis servicemen are authorized to pay Service Occupation Tax (which includes local taxes) based upon the cost price of tangible personal property transferred incident to sales of service. They remit the tax to the Department by filing returns and do not pay tax to suppliers. They provide suppliers with Certificates of Resale for the property transferred to service customers.

The final method of determining tax liability may be used by de minimis servicemen that are not otherwise required to be registered under the Retailers' Occupation Tax Act. Servicemen may qualify as de minimis if they determine that their annual aggregate cost price of tangible personal property transferred incident to sales of service is less than 35% of their annual gross receipts from service transactions (75% in the case of pharmacists and persons engaged in graphic arts production). Such de minimis servicemen may pay Use Tax to their suppliers or may self-assess and remit Use Tax to the Department when making purchases from unregistered out-of-State suppliers. Those servicemen are not authorized to collect "tax" from their service customers, nor are they liable for Service Occupation Tax. It should be noted that servicemen no longer have the option of determining whether they are de minimis using a transaction by transaction basis.

If persons are engaged in the business of processing and delivering merchandise for others they are subject to either Service Occupation Tax liability or Use Tax liability, as described above, on any tangible personal property that they transfer incident to the sales of that service. For example, this would apply to any packaging materials that are transferred by a serviceman engaged in the business of processing and delivering merchandise for others. Please note that where the tangible personal property is located in this State at the time of its transfer incident to a sale of service, and is then delivered in Illinois, that transfer is subject to either Service Occupation Tax liability or Use Tax liability, as described above. If the serviceman is registered under the Service Occupation Tax Act and the tangible personal property is transferred incident to a sale of service under an agreement by which the serviceman is obligated to make physical delivery of the goods from a point in this State to a point outside this State, not to be returned to a point within this State, and such delivery is actually made, the transfer of that property is not subject to Service Occupation Tax liability. See the enclosed copy of 86

Ill. Adm. Code 140.501. Please note that no such exemption is provided under the Use Tax Act, and therefore, that exemption does not apply if the serviceman utilizes the final method listed above (the serviceman pays Use Tax to his/her suppliers).

Question 4: It does not appear that publishers described in your letter are engaged in making sales of service in Illinois. This being the case, those publishers would not have liability for Service Occupation Tax.

Question 5: See the answer to question number 3 above.

Question 6: It is possible that the out-of-State publisher may have a Service Use Tax liability, depending upon the manner in which the processor handles its tax liabilities as described in the answer to question number 3 above.

Question 7 (listed as the second question number 5): Use Tax is imposed on the privilege of using, in this State, any kind of tangible personal property that is purchased anywhere at retail from a retailer. See the enclosed copy of 86 Ill. Adm. Code 150.101. This includes any equipment, supplies, or other materials used in this State. See also the answer to question number 3 above regarding tangible personal property transferred incident to sales of service.

Question 8 (listed as the second question number 6): See the answer to question number 2 above regarding nexus.

I hope this information is helpful. The Department of Revenue maintains a Web site, which can be accessed at www.revenue.state.il.us. If you have further questions related to the Illinois sales tax laws, please contact the Department's Taxpayer Information Division at (217) 782-3336.

If you are not under audit and you wish to obtain a binding Private Letter Ruling regarding your factual situation, please submit all of the information set out in items 1 through 8 of the enclosed copy of Section 1200.110(b).

Very truly yours,

Terry D. Charlton
Associate Counsel

TDC:msk
Enc.